# 4 SURVEILLANCE AND RESEARCH

## OVERVIEW

Just under half of the IMF's country-level spending on SDS is for bilateral surveillance, including research (see Figure 3.1). In December 2020, 24 out of 34 SDS were on the regular annual Article IV (AIV) consultation cycle, while the rest were on a 24-month AIV cycle, including 6 of the 8 Pacific Island microstates. The average number of missions per SDS during the evaluation period varied considerably across area departments (ADs), with an average of 7.3 among SDS in the Western Hemisphere Department (WHD), 5.6 in the Asia and Pacific Department (APD), 5.8 in the African Department (AFR), and 9.0 and 6.0, respectively, in the European Department (EUR) and the Middle East and Central Asia Department (MCD), with variations largely due to differences in AIV mission cycles and to the presence of programs (which normally means that the country is put on a two-year AIV cycle).

Overall, SDS representatives appreciated bilateral surveillance and considered it to be of high quality. This finding was consistently supported by the 15 country case studies for this evaluation and the survey of SDS officials. Similarly, staff who responded to the evaluation survey took a generally positive view of Fund surveillance in SDS, with almost two-thirds of staff deeming IMF surveillance to have added value "to a great extent" (de Las Casas and Balasubramanian, 2022b).

In interviews, country officials indicated that Fund surveillance was highly valued for two reasons. First, given the lack of other sources of macroeconomic analysis, the Fund was often the only authoritative outside source of comprehensive macroeconomic analysis, advice, and forecasting in many SDS. Second, Fund surveillance helped to fill the gaps created by the limited internal capacity in most of these countries, with Fund staff additionally helping to develop the skills of young country professionals in macroeconomic analysis, financial sector diagnostics, and country risk analysis. The staff's independent analysis of developments and policies and its exchange of views on fiscal policy and financial risks were considered particularly useful. Country authorities also valued the analytical work done by staff on forecasting the trajectory of the economy and assessing debt vulnerabilities in the context of medium-term macro-frameworks, which helped to highlight emerging risks and policy gaps.

One concern raised by country officials related to the frequency of AIV consultations, particularly in the Pacific region, especially the six microstates. The 24-month AIV cycle was considered to have negatively affected the quality of Fund engagement, including surveillance, by limiting continuity of policy discussion, reducing traction of policy advice, and eroding the visibility of the Fund.

Officials were generally appreciative of the extent to which surveillance attention was well-directed to particular country concerns, reflecting application of the 2014 and 2017 SGNs. Nevertheless, perspectives on the extent to which policy advice was sufficiently tailored to the specific circumstances of SDS members varied across regions. Among African SDS, there was significant perception of lack of adequate tailoring, while among Caribbean SDS, authorities generally felt that tailoring of policy advice had been adequate but needed to adapt more fully to emerging priorities and place greater attention to improving outreach. In Pacific SDS, authorities felt that tailoring could be enhanced through more focus on the practical implementation of staff policy advice and the ways to achieve it, including with the provision of related technical assistance.

Across SDS in all regions, staff, Executive Directors and country authorities felt that efforts to tailor policy advice to country circumstances were impeded by frequent mission chief and country team turnover and poor handover procedures, which interrupted continuity of members' engagement with the Fund, limited the depth of understanding of a country's particular circumstances, and required relationships to be regularly rebuilt (see Chapter 7).

Besides tailoring, policy advice was considered by officials to be most useful when it was specific and actionable. This was the case with most of staff's fiscal policy and financial sector advice, but less so in the context of advice on growth-related structural policies. In the latter areas, authorities felt staff recommendations often tended to the generic and lacked specificity—for example, general recommendations to upgrade education and skills, or advice to pursue diversification to boost growth without specific suggestions on sectors into which diversification was feasible or how to encourage it. Achieving greater specificity of advice was hampered by the fact that most consultation teams were staffed by generalist macroeconomists with limited participation from functional departments (again, see Chapter 7).

While the evaluation found the overall quality of Fund surveillance and policy advice to be high, traction (in terms of influence on policy implementation) proved to be more limited and quite uneven. Evidence from country studies showed that traction of surveillance was greater in the more advanced SDS with larger absorption capacity, for example among some African SDS including Mauritius and Seychelles. Elsewhere, the traction of Fund advice was too often hampered by the limited capacity in SDS to absorb and advance initiatives to address underlying problems beyond the day-to-day challenges. At the same time, country authorities ascribed limitations to traction to insufficient recognition by the Fund of specific country characteristics including political economy constraints, the generic character of policy recommendations, the lack of advice on implementation, lapses in the Fund engagement because of the 24-month consultation cycle, high staff turnover, and weak outreach. Greater integration with Fund capacity development could also be helpful (see Chapter 7).

Staff felt that the quality of the data provided for surveillance was often a limiting factor on surveillance work although it did not constitute a critical deficiency in most cases. Over 80 percent of respondents to the staff survey thought that data constraints had limited the impact of their work to a great or moderate extent. Common problems reported by mission chiefs were the time taken to address data shortcomings and that reviewers were often insufficiently aware of the data inadequacies and the limits this posed on application of surveillance diagnostic tools and indicators. There were also regional variations in data quality and their impacts on surveillance. For example, in Caribbean SDS, while staff reports indicated that data were broadly adequate for surveillance, thorough analysis and targeted policy recommendations in employment and other social conditions were stymied by significant data gaps.

Internally, the 2014 and 2017 SGNs were considered useful by staff in setting out the core priorities for surveillance discussions. Some staff saw the SGN as a useful checklist of surveillance topics that matched the policy focus of country officials and provided adequate flexibility to tailor surveillance discussions to the particular circumstances of each country. However, others felt that the note could divert attention from macro-critical issues or others of increasing interest to authorities but were not explicitly covered.
In the Caribbean, officials highlighted several emerging issues of macro-relevance that deserved increased attention, including crime, social issues, central bank digital currencies, the effect of technology on the financial system, and the Blue Economy, while Pacific SDS highlighted the need to cover more sectoral issues.

AD staff also highlighted the need for more flexibility in the review process for SDS surveillance. They noted that, given time constraints, reviewers sometimes take a box-ticking approach and that staff turnover in reviewing departments could limit awareness of SDS circumstances. Reviewers could also show more flexibility to take more account of limited institutional capacity and data availability as well as the most relevant issues for analysis. AD staff also observed that there was very limited knowledge of or reference to the SGN by reviewing departments.

Experience with virtual engagement, which had greatly expanded since the COVID-19 pandemic, was mixed. Both staff and authorities generally agreed that virtual interactions hampered trust building and made communication less fruitful. Moreover, in some countries, communications were limited by the lack of high-quality internet connections, particularly when country officials themselves had to work from home. On the other hand, virtual communications did allow contacts to be maintained in the absence of travel and brought some advantages in that virtual engagement allowed for more frequent interactions and for the incorporation of more functional department specialists to discussions, although in the experience of some departments these additional participants at times lacked sufficient context to be very useful. Virtual engagement also improved, in some cases, coordination with other international financial institutions (IFIs), especially in countries where coordination had been less regular prior to the pandemic.

## TOPIC-SPECIFIC ISSUES

The Fund's fiscal policy advice was regarded by officials as providing considerable value added to SDS.[17] Coverage was broad, including strengthening fiscal policy management, fiscal rules, fiscal responsibility legislation, debt sustainability, tax policy, and issues relating to SOEs and public-private partnerships. Surveillance attention to the fiscal policy implications of ND&CC, citizenship by investment programs, wages and salaries, public investment, pension policy, and public financial management also grew over the evaluation period. Fiscal surveillance and policy advice was supported by extensive research, policy guidance provided by the 2014 and 2017 SGNs, and country-specific analysis. Moreover, coverage was viewed as well-tailored to the country-specific challenges. Officials generally appreciated the Debt Sustainability Assessments (DSAs) of SDS, particularly after reforms to the DSA methodology were introduced to reflect greater sensitivity to climate-related risks, though there are still limitations in how the DSA methodology was implemented in the SDS context (see the subsection in this chapter on Debt Sustainability Assessments).

Notwithstanding considerable attention and the use of sophisticated analytical tools, the traction of Fund fiscal policy advice was uneven. In the tax policy sphere, for example, the introduction of a value-added tax (VAT) or reforms to an existing VAT occurred in eight SDS; and overall revenue performance improved for two-thirds of SDS. However, efforts to reduce wasteful and unproductive expenditure proved more difficult, although reductions in the public sector's wage share in GDP occurred in eight SDS. Beyond the issues already flagged of lack of capacity and the need for greater granularity of advice, implementation was also hampered at times by political resistance, underlining the need for taking full account of political economy constraints. Moreover, progress in achieving fiscal consolidation was often set back by the impact of natural disasters as well as challenges in handling the fiscal legacy issues mentioned above, particularly in some Pacific SDS.

Financial sector issues received substantial coverage in AIV consultations during the evaluation period.[18] There was, for example, ample attention to anti–money laundering and combating the financing of terrorism (AML/CFT) and correspondent banking relationship (CBR) issues—two emerging issues of major importance to SDS. Regarding AML/CFT, 98 percent of staff reports devoted at least one unique paragraph to either advocate for strengthening of frameworks or to report on progress being made. Similar attention was paid, especially in the second half of the review period, to CBR issues. In addition to 73 percent of staff reports referencing the issue, the Fund undertook a range of analytical work resulting in a note to staff in 2017 to help country teams discuss these issues in consultations and to guide data gathering to assess the impact on members. Advocacy initiatives included the Fund's active membership in the Financial Action Task Force, the Basel Committee on Banking Supervision groups and the Financial Stability Board.

[17] For a detailed analysis of the Fund's work on fiscal issues, see Heller (2022).

[18] For a detailed analysis of the work on financial sector issues, see Marston (2022).

There were, however, noticeable gaps in financial sector coverage. First, SDS were disproportionately underserved by the Financial Sector Assessment Program (FSAP), with only 8 SDS FSAPs among 122 FSAPs in the evaluation period, and only 2 other SDS FSAPs since the launch of the FSAP, despite evidence of traction and responsiveness to findings in SDS, often within a year of FSAP conclusion (see the subsection in this chapter on Debt Sustainability Assessments). In addition, there were two Financial Sector Stability Reviews (FSSR), which is a more limited diagnostic capacity development tool. Given challenges of financial deepening in SDS, the FSSR, with its focus on stability rather than developmental issues, has not proven to be a full substitute, although World Bank teams at times complemented the FSSR work by using the FSAP developmental modules. Second, in AIV consultations, issues associated with financial stability, macro-financial linkages and resilience were largely well treated, although much less attention was paid to development issues of particular importance and macrocritical in SDS, like inclusion and credit access.

Attention to ND&CC in surveillance work strengthened considerably during the evaluation period, especially with the introduction of two special diagnostic tools, the CCPA and the Disaster Resilience Strategy (DRS) (see the subsection in this chapter on Debt Sustainability Assessments).[19] While attention in the early years of the evaluation period to ND&CC issues was sporadic, the introduction of CCPAs in 2017 provided a galvanizing framework to improve coverage of climate issues in AIV reports and build analysis of ND&CC effects in the frameworks used for assessing macroeconomic policies. Internally, they helped build a critical mass of knowledge, organizing efforts and innovating on the delivery of surveillance. Externally, they served to strengthen engagement with partners and country authorities on macro critical issues. In the two DRS pilots, the broader DRS framework proved a useful, three-part policy framework for building resilience and costing resource needs, although the financial follow-through was not operationalized. Moreover, DSAs for SDS systematically included stress testing to account for the impact of natural disasters; and growth projections and fiscal policy advice were calibrated to reflect ND&CC concerns.

The approach to ND&CC in AIV consultations also evolved Fund-wide over the evaluation period. Periodic Fund-wide reviews of IMF surveillance early in the evaluation period emphasized the importance of tailoring advice to country circumstances, but did not pay much attention to the particular challenges of SDS arising from ND&CC. Following the 2014 SGN, the Fund's 2015 Guidance Note on Surveillance (IMF, 2015a) specified that surveillance in SDS should be tailored to their particular circumstances, including their vulnerability to natural disasters and initiatives to strengthen resilience, but provided limited specific guidance relevant to ND&CC. Staff were encouraged to utilize Risk Assessment Matrices as a structured framework for analyzing risk but natural disasters were not referred to as a risk despite their (increasing) frequency for this part of the membership. More recently, there has been a more thorough attempt to integrate climate change considerations into the surveillance framework. The 2021 Comprehensive Surveillance Review (IMF, 2021a and 2021b) recognized climate change as a "potentially existential threat with significant macroeconomic and financial implications" (IMF, 2021a, p. 20) for which meaningful policy actions were required.

On growth-related issues, country authorities generally welcomed advice in AIV consultations on the challenges faced by SDS in strengthening growth performance.[20] At the same time, they drew attention to the need for more granular advice on this area, including more detailed policy advice on approaches to diversification and developing new sectors of their economies, and further knowledge-sharing of experiences of other SDS facing similar growth-related challenges. Pacific SDS in particular considered the discussion of growth-related issues as being quite limited. This would seem to be an area where the Fund's traditional core expertise is likely to be stretched, suggesting a need for closer collaboration with development partners.

[19] For a detailed analysis of the work on ND&CC, see Lombardi and Rustomjee (2022).

[20] See Rustomjee, Balasubramanian, and Li (2022).

## SURVEILLANCE TOOLKIT

The usefulness of various surveillance tools in the SDS context—including DSAs, FSAPs, FSSRs, CCPAs, DRSs, and External Balance Assessment (EBA)—varied across countries with different levels of development.

### Debt Sustainability Assessments

DSAs were broadly perceived as useful, although too complex for some SDS (Heller, 2022). Two-thirds of SDS were subject to the LIC-DSA framework carried out jointly by the IMF and the World Bank, with the remainder subject to the DSA for market access countries (MAC DSA). Two-thirds of the latter group received the more detailed analysis for high-scrutiny market-access countries. In recent DSAs, coverage of debt vulnerabilities and their impacts on fiscal policy was extensive.

Reforms to the DSA methodology—both the LIC-DSA and the MAC DSA—over the evaluation period helped improve the quality of assessments of risks to fiscal policy brought about by debt accumulation. The ability to apply tailored shocks as a supplement to standard shocks broadened and enriched analysis of the potential impacts of shocks in SDS. Progressive improvements in the DSA methodology introduced more sophisticated ways to gauge the realism of debt projections for policies and the economic environment. Changes to the methodology also enabled projections to be stress-tested for the impact of potential unexpected shocks relevant to SDS, including natural disasters, SOE defaults, and the unexpected emergence of contingent liabilities. The use of tailored shocks also provided an opportunity to broaden coverage of the risks to debt sustainability by incorporating the impacts of climate change into DSAs, with staff able to incorporate some form of tailored shock to reflect the adverse impact on real growth from the impacts of climate change (e.g., drought, changed precipitation patterns) that occur more broadly over the medium term.

Notwithstanding these gains, scrutiny of recent DSAs in SDS also suggests some gaps in the making of these assessments and opportunities to further improve their utility. At present, the baseline scenario in most fiscal projections for SDS does not include the outlays for infrastructure maintenance or climate resilient investments warranted in the context of exposure to ND&CC shocks. This would be appropriate and could be facilitated by wider application of CCPAs. In addition, while the current DSA methodology allows for the possibility of combined shocks, it is increasingly important to introduce this approach more systematically in SDS DSAs, particularly in assessing risks in the context of multiple shocks and in the treatment of climate-related shocks, building on the heat-map approach currently used in the MAC DSA framework and adapting this for SDS, for example by including a standardized text box in DSAs on the fiscal consequences in the event that several severe risks were to materialize simultaneously.

The experience of many microstates suggests that providing the debt data required for the DSA exercise may be challenging, given their limited administrative capacity. This particularly applies to the borrowing of SOEs or loans from private or bilateral creditors for the financing of government investments. Simplification of the DSA framework for these microstates could help to alleviate pressure on authorities to supply necessary data, while retaining the core benefits derived from the periodic DSA exercise, including formal monitoring of the most important risks and threats to the projected fiscal path precipitated by unanticipated debt accumulation. A linkage of the DSA work in the context of surveillance with the application of other fiscal risk assessment management tools (of both the IMF and World Bank) may be particularly valuable in mitigating climate-related debt vulnerabilities.

### Climate Change Policy Assessments

CCPAs were introduced in 2017 on a pilot basis as a collaborative IMF–World Bank effort. They assessed macroeconomic and sectoral aspects of climate change policies in countries particularly affected by climate change and took stock of a country's plans from the perspective of its macroeconomic and fiscal implications by providing a holistic assessment of the relevant policy framework. In so doing, they aimed to improve country prospects for attracting external finance and offer valuable policy input into their climate strategies.

Six pilot CCPAs were completed, all for SDS. A Fund review of experience with CCPAs in 2021 found that CCPAs had been most helpful in identifying financial, policy, and institutional capacity gaps; detecting linkages between climate change and the macro framework; and identifying the impact of climate change risks and to some extent facilitating national planning. CCPAs had also fostered collaboration within the national administration on climate change issues and had promoted engagement with international stakeholders.

For country teams, CCPAs enabled the building of a critical mass of knowledge on the impact of ND&CC effects, providing a base to leverage for policy analysis. CCPAs also offered a structured framework for engaging the World Bank and other partners, resulting in effective collaboration, in line with earlier IEO findings (IEO, 2020). However, in the absence of a CCPA, the Fund often just referred to World Bank work on ND&CC issues, without seriously integrating results in the macroeconomic framework.

The Fund is now in the process of enhancing its overall approach to climate policy work. In 2021, the World Bank decided to discontinue its participation in CCPAs and to prepare its own report (Country Climate and Development Report). Building on the CCPA experience, the IMF is currently developing a new diagnostic tool called the Climate Macroeconomic Assessment Program (CMAP) to analyze climate change policies and preparedness for climate-vulnerable countries. The Fund aims to scale up to 10 reports per year as inputs for AIV consultations. In July 2021, the Board discussed a staff paper on the IMF's climate strategy that explored the resource needs to scale up the Fund's climate work (IMF, 2021c). Directors supported a more comprehensive coverage of climate change–related policy challenges in AIV consultations, where macro-critical, as well as staff's proposal to regularly cover adaptation and resilience building policies for those countries most vulnerable to climate change. Directors also agreed that FSAPs should have a climate component where climate change may pose financial stability risks and stressed the importance of partnering with other institutions. In December 2021, the Board agreed to provide substantial additional resources to support the Fund's climate work in the context of a broader one-time augmentation of the IMF's budget to help the Fund deal with growing challenges.

## Disaster Resilience Strategies

Building on the Fund's increasing attention to ND&CC issues, in 2019 a Board paper (IMF, 2019) developed an organizing framework for supporting resilience building in disaster-vulnerable countries. Emphasizing benefits of taking early actions to enhance resilience and against the backdrop of substantial underinvestment, the Fund recommended that vulnerable countries build disaster resilience through a three-pillar strategy aimed at structural, financial, and post-disaster resilience. The ensuing DRS could provide an organizing framework to assess and advise on financing needs associated with managing vulnerabilities related to natural disasters and help develop a country-owned resilience-focused document drawing on national processes, strategies, plans, as well as a CCPA (if available) and comments from key partners; and help integrate macro and micro reforms for building resilience and prioritizing policies and actions.

DRSs were completed for two members, both Caribbean SDS, and discussed by the Board in 2021. These reports were helpful in terms of developing an estimate of the cost of a climate-resilience strategy by providing a holistic and internally consistent framework for appraising the various interrelated components. The DRS exercises for these countries also triggered underlying administrative processes within their respective governments. They built upon—and brought consistency among—a wide array of domestic sectoral strategies, plans, and projects already launched by setting a common, unifying standard under which to appraise, amend, and then implement them. They also drew from—and successfully built upon—initiatives sponsored by multilateral institutions and development partners.

However, while the DRS reports benefited from a compelling analysis of the macroeconomics of resilience, drawing from Fund surveillance and underlying research, what was left unclear was how the partners—including the IMF, which had proactively supported the drafting of such documents—would follow up on the intended aims of the DRS in terms of providing financial support for the large investments required. In this regard, the new RST now being developed to channel part of the 2021 SDR allocation to support the needs of countries to build disaster resilience could provide an important step forward.

## Financial Stability Assessment Program[21]

FSAPs as well as the new FSSR diagnostic tool were seen as very valuable when they occurred by providing granular well-tailored advice, but their use was quite limited in SDS. During the evaluation period, a total of eight FSAPs, five of which were updates of previous FSAPs, were completed for six SDS. All but one of these FSAPs were for countries classified as offshore financial centers.[22] FSSRs were conducted in two SDS. Thus, 25 out of 34 SDS have never had an FSAP or FSSR although the 6 East Caribbean Currency Union (ECCU) members benefited from the 2004 ECCU FSAP.

There could be scope to look for economies of scale to leverage the value of the FSAP tool to SDS by exploring regional or thematic approaches that could group several countries with similar issues together.[23] Greater use of the less resource-intensive FSSR could help deepen analysis of financial sector challenges in SDS but to be most relevant to SDS concerns would need to extend to macro-critical development as well as stability issues.

## External Balance Assessment

Unlike these other tools, the introduction of the EBA-lite tool in 2015 proved to be of little use to surveillance in SDS.[24] Country authorities and staff commented that the tool was poorly understood and too complex for the needs of most SDS and provided little helpful guidance for policy assessment and advice. It added scarce value to country authorities due to data gaps and presented difficulties in interpretation in the case of dollarized/euroized economies. They suggested that a less mechanical and more eclectic approach to assessing external balances in SDS would be useful.

## REGIONAL SURVEILLANCE

Regional surveillance provided the opportunity for cost effective analysis across SDS experiencing similar problems, helping to share lessons and encourage common approaches and solutions. All relevant ADs made efforts to conduct regional surveillance for SDS work but used different approaches.

Most formal were the annual consultations with ECCU conducted by WHD, which covered monetary and financial sector policy issues for the six member countries. This annual exercise was seen as helpful by staff and authorities in focusing on the common challenges in the currency union and the policies needed to address them. Recent ECCU consultations have presented research and tailored advice on climate change and on digital currencies. Teams have also consulted with regional public sector entities, while the Fund has also held regional seminars and events during the Annual and Spring meetings on regional-specific issues such as CBDC and CBR.

More generally, ADs conducted regional analysis on SDS issues on a more ad hoc basis, particularly in the departments' Regional Economic Outlook (REO), although each department took a somewhat different approach to such work. WHD included a regular sub-chapter in biannual REOs on recent macroeconomic developments in Caribbean SDS, providing a concise regular snapshot of key macroeconomic and growth-related policy challenges. APD also included content in biannual REOs, albeit much more sparsely, while substantially augmenting coverage of Pacific SDS' growth policy and related macroeconomic and structural policy developments through a generally biannual Small States Monitor. AFR featured periodic, detailed content on growth-related challenges in SDS, albeit without differentiating these members based on population size.

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[21] FSAPs and FSSRs are classified as part of the IMF's technical assistance and not surveillance tools per se, except for the subset of members with systemically important financial sectors subject to mandatory financial stability assessments. Nevertheless, they are closely coordinated with, and inform, bilateral surveillance.

[22] FSAPs were conducted for The Bahamas, Barbados, Mauritius, Montenegro, Samoa, and Trinidad and Tobago; all of these except Montenegro are classified as offshore financial centers (according to the list in IMF, 2015b).

[23] For further details, see Marston (2022).

[24] EBA-lite is a simplified version of the full External Balance Assessment (EBA) applied to 30 advanced and emerging market economies and is intended to be more appropriate for the circumstances of small and simpler economies.

Country officials felt that such regional analysis allowed member countries to share knowledge and learn about policy experiences in other countries, although they also emphasized that the unique characteristics of individual countries needed to be kept in mind when providing country-level advice. Staff felt that their research on regional issues had helped inform domestic policy considerations and bilateral policy advice, for example, contributing to Dominica's DRS. However, some staff felt that the balance of resource allocation between regional and bilateral surveillance had swung too far toward the regional and noted that research at the regional level had failed to develop much traction at the country level because it often did not have a clear connection to the immediate policy concerns of individual countries.

## RESEARCH

The Fund's policies and guidance on SDS developed during the evaluation period and its bilateral surveillance policy advice was underpinned by a substantial body of internal research. Following a growing external (i.e., non-IMF) literature[25] on small states during the late 1990s and early 2000s, the Fund's analytical work on the specific challenges of SDS gained momentum in the 2010s, focusing on the macroeconomic challenges of these countries. Initially appearing mainly as IMF working papers, this work evolved over time to include several books and compilations of regionally oriented studies focusing particularly on Caribbean and Pacific SDS.

Much of the IMF's SDS research was focused on specific thematic areas of interest to SDS. Fund staff began exploring vulnerabilities to ND&CC effects in the 2000s and stepped up this work during the evaluation period. This research confirmed the finding that SDS are disproportionally affected by ND&CC effects and focused on those aspects most relevant to the Fund's mandate: the macroeconomics of disasters and recovery (including the incorporation of natural disasters' costs to macro projections and debt sustainability analyses), their impact on growth, and the need for resilience-building and disaster preparedness.[26]

Beyond the predominant fiscal element of the Board policy documents discussed in Chapter 3, staff developed during the evaluation period a significant body of research discussing the specific fiscal challenges of SDS, ranging from their sensitivity to natural disasters, the policy challenges of managing natural resource assets, and the fiscal management issues associated with small population bases. Together, these papers have provided a substantive foundation for the Fund's engagement on fiscal policy issues in SDS since 2013.[27]

IMF research to understand and address the unique challenges experienced by the financial systems of small states and the implications for broader economic resilience steadily intensified during the last decade. In the initial years of the evaluation period, this research centered on core macroeconomic and macro-financial challenges in shallow financial markets. The focus shifted in the middle of the evaluation period to conjunctural challenges facing SDS, particularly the assessment of climate shocks and the impact and management of regulatory spillovers in the form of the withdrawal of correspondent banking relationships. Research during the final years of the evaluation period was more solution-driven, dealing with issues like financial inclusion, the prospects for financial technology, and regional approaches to common issues in SDS.

Much research on SDS is done by individual surveillance country teams and distributed in Selected Issues Papers (SIPs) issued as background to AIV consultation staff reports. The major policy issues covered in SDS SIPs were fiscal policy, financial sector, and growth-related policies, together with monetary and exchange rate policies and ND&CC (Figure 4.1). Over the evaluation period, 54 SIPs were prepared for SDS members, including 28 for Caribbean SDS, 13 for African SDS, 9 for Asia and Pacific SDS, and 5 for MCD and EUR SDS. Each of these SIPs typically included several separate notes, covering areas of special interest for SDS such as tourism, dollarization, export diversification, and debt—catalyzed by early efforts by the interdepartmental SDS working group.

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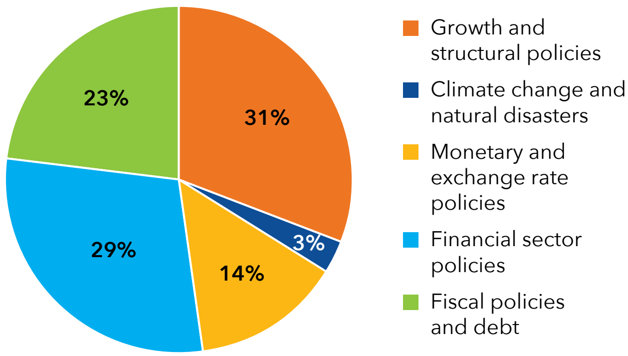
[25] For a review of the external literature on growth issues in SDS, see Briguglio (2022).

[26] For further coverage of IMF research on ND&CC, see Lombardi and Rustomjee (2022).

[27] For a detailed analysis of IMF research on fiscal issues, see Heller (2022).

**FIGURE 4.1. POLICY ISSUES IN SDS SIPs, 2010–2019**




Sources: IMF; IEO calculations.

Many of these pieces were of high quality and contributed to the depth and concreteness of analysis supporting the staff's policy recommendations, and as such were well appreciated by country officials. In some cases, traction was best served when the subject matter of SIPs remained on a broadly similar theme, especially when prepared for annual consultation cycles, with continuity of policy subject matter across a suite of SIPS serving effectively as building blocks in encouraging policy action (Marston, 2022). Despite an active research program in APD on cross-regional issues, the absence of SIPs for individual Pacific SDS has limited in-depth consideration of surveillance issues specific to the member country. These issues are linked in part to staffing constraints on SDS.

A number of reports with a regional focus were produced during the evaluation period. Acevedo and others (IMF, 2013a) argued that Caribbean small states, while sharing many features of other small states, have specific characteristics—both structural and policy-driven—that negatively affect their growth and fiscal balances. A more recent publication on Caribbean SDS (Alleyne and others, 2018) discussed policy options for promoting a sustained and inclusive economic growth, arguing that these economies need to improve their fiscal positions, thin financial markets, and monopolistic structures. Publications on Pacific SDS include Yang and others (2013), Tumbarello and others (2013), and Cabezon and others (2016). The latter discussed intrinsic factors affecting economic growth in these countries, including small populations and markets, remoteness, vulnerability to ND&CC, and narrow production bases.

## COLLABORATION WITH PARTNERS

The extent and quality of cooperation with development partners working on SDS was mixed, varying widely across countries, regions, and institutions involved, and reflecting the personalities of the individuals in charge. In general, cooperation was better on the ground than in HQ, with IMF field staff making a big positive difference, and more intensive when countries were under a Fund-supported program. In many SDS, engagement with local institutions and donors—e.g., CDB, CCB, and Canada in the Caribbean, and Australia and New Zealand in the Pacific—was very active, not least through their engagement with Regional Capacity Development Centers (RCDCs). However, high staff turnover, both at the Fund and in other institutions, made collaboration more difficult.

Cooperation with the World Bank generally worked well in terms of consulting on work programs and top-line issues. The staff survey conducted for the evaluation revealed that the World Bank was the most frequent partner in SDS and 85 percent of respondents considered this collaboration effective.[28] However, interaction with the Bank was seldom very deep in terms of collaboration on research, analysis, or policy advice, consistent with findings of recent IEO evaluations (IEO, 2020; 2021). This lack of in-depth collaboration may have contributed to SDS frustration that the Fund does not provide much value added on important real economy issues, such as employment, diversification, or resilience building, in which tapping the expertise of the Bank and other partners could have helped to deepen the Fund's contribution. A potentially major setback to collaboration was the decision in 2021 for the IMF and the World Bank to have separate rather than joint climate change assessments. The new RST could provide a vehicle for closer collaboration on these issues, albeit in countries with interest in using the new facility.

The Fund participates in the Small States Forum, which holds regular meetings among its 50 members organized by the World Bank. However, there is ample room to deepen

[28] For further details, see de Las Casas and Balasubramanian (2022b).

the Fund's participation, to use it more effectively as a platform to present the institution's work on SDS and to explain the tools and resources available for this section of the membership. The Fund could also participate on a more regular basis in regional forums in the Caribbean and Pacific bringing together senior policymakers to discuss salient policy concerns.

## OVERALL ASSESSMENT

Bilateral surveillance was widely appreciated by country authorities and considered to be of high quality. In the absence of alternative sources of macroeconomic analysis—especially for the most capacity-constrained SDS—Fund surveillance was often of paramount importance. Going forward, SDS' reliance on Fund analytical work and policy advice places a strong onus on the Fund to maintain these high standards.

Coverage of surveillance topics was generally seen as being in line with the staff guidance notes, helping to ensure relevant advice on the key fiscal policy, financial sector, and growth-related challenges facing SDS. Fiscal policy advice in particular coalesced closely around the particular fiscal policy challenges faced by SDS that were tourism-dependent, natural resource–dependent, benefiting from financial asset legacies, or structurally challenged. Nevertheless, some gaps can be identified, particularly in financial sector coverage, with relatively little attention paid to financial sector development issues such as access to credit and financial inclusion  as well as to real sector topics related to economic diversification and growth. Greater attention could also have been given to some emerging issues with macroeconomic impact that have become important priorities for country authorities, including crime, employment, social issues, digital currencies, technology, and microeconomic issues. From this perspective, while the SGNs had value in guiding prioritization and serving as a useful checklist, future SGNs could provide more flexibility to adapt to newly emerging surveillance priorities.

Despite well appreciated and generally well-focused advice, the traction of SDS surveillance seems to have been uneven. Traction has typically been greatest in higher-income SDS with more developed institutional capacity, but less in others with more limited absorptive capacity. It has to be recognized that traction is affected by factors outside the IMF's control, including political economy circumstances. Nevertheless, a number of factors internal to the Fund also have affected traction.

More continuity of staff engagement could have helped increase the impact of surveillance work. While the frequency of missions was seen as satisfactory by most Caribbean and African SDS, Pacific micro-states considered the 24-month AIV cycle to have negatively affected the quality of Fund engagement. There is also evidence of reduced satisfaction with Fund surveillance engagement during the pandemic, which seems to have disrupted contacts despite use of virtual communications.
An amplifying concern discussed in Chapter 7 related to the high turnover and low tenure of mission chiefs and team members and a shortfall in handover procedures, which made it harder to build understanding of country conditions and develop strong relationships with local officials.

A related concern that may have impeded traction relates to the sometimes too generic character of Fund advice. Officials would generally appreciate more granularity and greater attention to how to meet country-specific implementation challenges. Two factors that may have contributed to a tendency for a lack of granularity are the high turnover of teams working on SDS, which limited detailed understanding of country circumstances, and the general limited involvement of the specialists from functional departments as either team members or part of the review process.

Effective use was generally made of the evolving array of surveillance tools to support surveillance in SDS, as Fund-wide reforms to aspects of the toolkit helped to allow more relevant application in the SDS context. Adjustments to the DSA methodology substantially broadened the coverage—and strengthened the quality of assessments—of risks to debt sustainability, a significant advance to many SDS that are at high risk of debt distress or have unsustainable debt levels, although there remain some gaps in application. Similarly, the introduction of the CCPA and DRS brought multiple gains to surveillance of ND&CC challenges in SDS, providing a framework to assess the broader macroeconomic implications and to bring in development partners such as the World Bank.

In other areas, the toolkit has been less valuable to SDS; they were generally underserved by the FSAP program and the EBA-lite proved too complex and of limited value. Recognizing the high cost of FSAPs and the need to focus scarce resources to the assessment of systemic financial systems, consideration could be given to alternative approaches for SDS, such as (i) more frequent use of a regional or thematic approach that focused on cross-cutting issues of SDS concern, in search of economies of scale; and (ii) adapting the FSSR tool to give greater emphasis to developmental and resilience aspects.

Data gaps were a limiting factor in surveillance work on many SDS, particularly for data-intensive diagnostic tools, including DSAs. The problem was made worse by the work-intensive and protracted data gathering process often required in SDS, combined with the relatively scarce resources available to country teams. To alleviate these pressures, ADs could make greater use of research assistants, providing mission chiefs and desk economists with more time to focus on tailoring advice.

Regional surveillance was widely appreciated by SDS members and was tailored to the particular regional challenges of Caribbean, Asia-Pacific, and African SDS. Differing modalities among ADs served an important purpose in tailoring but may have limited the opportunity to distill collective lessons of experience across SDS members. Going forward, there is scope for ADs to better share experiences and current practices in developing regional and common issues across regions in surveillance for SDS.

The quality of IMF bilateral and regional surveillance during the evaluation period benefited from the stepping up of research on SDS issues over the evaluation period, and for using this research to support its SDS policy analysis and guidance. However, the benefits of research for SDS work could be further enhanced, through closer links between country research and policy analysis, including through more strategic choice of SIP topics that are less generic and that allow for more granularity and better align with country-specific characteristics and challenges; by developing stronger and more concerted links between regional and country research, building on the strong body of region-specific research on SDS issues already developed by ADs and applying lessons and insights to individual country circumstances. There is also a need for more global research on challenges common to most or all SDS that more effectively draws together and shares policy lessons, data, and good practices, for SDS in all regions. Such challenges include macro-critical impacts of climate change; vulnerability to shocks, including trade- and natural disaster–related shocks; and the need for deeper and more sound financial systems. Finally, the quality of bilateral and regional surveillance for SDS could be enhanced through strengthened collation and consolidation of macroeconomic, financial sector, debt, climate, and other data, to facilitate analytical and research work on SDS and to promote cross-regional knowledge sharing.

While collaboration with the World Bank and other international organizations and donors has worked reasonably well in most cases, there is scope for deeper engagement. Fund staff do not currently have the skill set to add much on some macro-critical issues, particularly in the real sector of the economy, which makes collaboration with other agencies paramount as a way of enriching the Fund's contribution. Moreover, recent institutional decisions on climate change could imply a step backwards. As observed in the recent evaluation of Bank-Fund collaboration on macro-structural issues (IEO, 2020), strengthening collaboration will require attention to how to incentivize collaboration both in the Fund and in partners as well as facilitating knowledge exchange. Simple tools like the creation and maintenance of multi-institution country platforms, where research projects, policy initiatives, timetables, and contact details could be shared, would be useful.